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General Business Conditions

THE sudden German attack upon Russia, which has made the past month one of the most eventful since the beginning of the war, probably should be interpreted as increasing the likelihood of a long war; and in terms of the economic situation in the United States, a long war will mean a further growth of armament expenditures, further stimulus to defense work and disturbance of peacetime business, and further grave decisions for the United States to make in its international relations and economic policies. To most observers in this country, where there had been little evidence that the Germans could not accomplish their Russian aims as effectively by diplomatic as by military means, the attack came as an astounding surprise. Its plain implication is that the Germans were not obtaining all the supplies they thought they could get, or securing as complete Russian collaboration in economic and foreign policy as they thought they could win by military victory.

The effects of this move upon the course of the war necessarily depend upon the outcome of the military action. Great Britain has gained at least a breathing spell, and temporarily is freed from many anxieties. She will gain a great deal more if the Russians hold, and if she can make the most of the time given her. On the other hand, military experts generally hold that the balance of power, experience and quality of material as between the Germans and the Russians is with the former, and Great Britain will be the loser in the long run if Russia is quickly conquered, or if the most productive Russian territory and resources come under German control. The surest way that Germany can find to break the British blockade and withstand a long war is to obtain Russian wheat, oil and cotton. Also, the removal of the threat of Russian armies from the German rear will release stronger forces for the battle against Britain than have yet been employed.

In many quarters attempts are being made to reappraise the position of this country. It is plain, however, that our fundamental policy of arming ourselves and giving aid to Britain will in no way be altered. The Administration has been prompt to declare that we will go on with our program, if possible with redoubled effort, and the declaration has been endorsed by the press and public opinion. The national defense is the paramount interest of the country. Aid to Britain is part of the policy, adopted by constitutional process, and supported by an overwhelming public sentiment.

There is no reason to anticipate any immediate new effect upon the business situation, since there is at present no lack of incentive, effort or appropriations to get arms expenditures moving faster, and production is bumping against the ceiling of capacity. However, business observers are warranted in assuming that another reason has been added to those which call for increasing the speed and effectiveness of the defense effort.

Subordinating Non-Defense Output

The influence of the defense program is dominating business increasingly as time goes on. For a year the country has been expanding its armament production, and making preparations for further major increases, without requiring any considerable diversion from non-defense output; but the developments of recent months have made it plain that this condition cannot continue indefinitely, and that the coming increases in armament will be more and more at the expense of normal industrial operations. Shortages of materials are beginning to tell, as stocks on hand run down and substitutions become more difficult to make. A survey among manufacturing companies made by the National Industrial Conference Board shows that more than one-fourth of those covered are now reducing output of non-defense items, while nearly 80 per cent expect such curtailment within a few weeks or months, due chiefly to difficulties in obtaining materials, but in part to concentration on defense contracts.

Priorities are spreading at an accelerating rate. The number of items on which preference ratings are issued is now well over 300; and

the smaller list upon which the Government has taken over full or partial allocation of the available supplies is increasing. These are significant of tightening situations which require the industries, particularly those using metals, to make troublesome adjustments. Import controls are adding their difficulties. In certain necessary materials where no present shortage exists the Government is taking precautions to protect future requirements. It has ordered all users of rubber to restrict their operations and has constituted itself the sole buyer and importer of rubber, for the purpose of controlling supplies. All supplies of zinc have been made subject to Government allocation, and copper producers will hereafter be required to furnish part of their output to the priorities division of the O.P.M. for distribution to defense uses. The steel trade reviews say that 65 to 70 per cent of all steel orders now carry preference ratings.

This is duplicating the experience of the last war. The supplies of commodities available are vastly greater than twenty-five years ago, but requirements also are greater. This country will experience fewer shortages of non-defense goods, and come closer to having both guns and butter, than any other. It still has reserves of labor available, which can be drawn into the industries as rapidly as skill and training can be imparted. Plainly, however, there are other bottlenecks than labor. At present the chief bottleneck is in the critical materials and machines. There is no assurance that others may not appear, perhaps in transportation, fuel, or power.

It should not be inferred that the appearance of production difficulties has resulted in any curtailment of aggregate production, for on the contrary industrial operations are still expanding. Even manufacturing companies which are meeting difficulties in filling non-defense orders are busy with defense contracts and instances of actual curtailment or layoffs of labor have been few. Awards of defense contracts continue to run into hundreds of millions monthly — the total for May was $879 millions—and of the new defense plants started during the past year far more are still under construction than are in production. This portends further expansion as time goes on. Meanwhile, the Federal Reserve index of industrial production has soared to record figures, 149 in May (1935-39 = 100), compared with 140 in January, and 115 in May a year ago before the defense effort was started. June and July figures are expected to be still higher.

Spreading Price Controls

Along with spreading priorities go spreading price controls. Prices have been strong through the month, with both uncontrolled staple materials and manufactured goods moving up faster. As the rise has extended, Mr. Henderson's Office of Price Administration and Civilian Supply has become more active. Ceilings have been put upon hides, at 15 cents, and upon pig iron; and announcement has been made of the intention to fix the price of cottonseed oil considerably below the recent market. The last is Mr. Henderson's first venture into the field of farm commodities, and his announcement has evoked representations from Congressmen representing the farm States, the more so as wheat and cotton reacted with cottonseed oil and lard upon the news.

Mr. Henderson has also extended his activities more into the field of manufactured goods than heretofore. He has placed ceilings upon six types of cotton gray goods, substantially below recent quotations in the markets. He has requested that tire prices be held at the levels of June 17, and that furniture prices not be raised without consultation with his office. He also attempted to secure the withdrawal of automobile price advances announced early in the month, and when the Chrysler Corporation took the position that it could not entirely rescind its advances, he declared his intention to fix automobile prices in the next model year.

It was inevitable that price controls should extend to manufactured goods, once the basic policy of applying direct pressure upon the markets was adopted. The first idea of the authorities was to restrain general advances by keeping down prices of key basic materials; but experience has shown that this was not wholly effective, for there are too many other elements of cost entering into finished goods. Moreover, it was impracticable for Mr. Henderson to apply the principle to materials produced on the farms, in the face of Congressional action which raised the prices of basic farm staples, together with the need to stimulate production of food products particularly wanted for Great Britain's requirements. He could not prevent advances of prices of imported materials, which reflect higher shipping costs and ocean freight rates as well as actual interference with imports through shipping diversion and priorities.

A third major cause of the upward price trend has been the increase in industrial costs due to wage increases. A fourth cause stems from the other three, namely, the general desire to buy ahead for fear of delivery difficulties and advancing markets.

Elements in Price Problems

A bare enumeration of these causes indicates the complexity of the problem of controlling prices of manufactured goods by direct regulation, at a time when price raising influences in some other respects are permitted virtually full sway. The real lack is of an integrated national policy for dealing with these trends.

In his statement concerning the refusal of the Chrysler Corporation to reduce prices as

much as requested, Mr. Henderson pointed to earnings of $37,800,000 shown in the Corporation's 1940 report. These earnings were the Corporation's share of a year's work, during which it paid for materials, labor and taxes $645,000,000. Disbursed as dividends, and reinvested by the Corporation, the earnings have done their share both to support the business situation and to keep the Corporation in strong condition, able not only to make important contributions to defense production and to finance future growth and operations, but to build up reserves against the inevitable ending of the boom.

Doubtless a principal reason why the Corporation wishes to establish prices on its cars which will show a profit for the next year also is that it does not want to dissipate its reserves and financial strength. The cars upon which it earned the profits last year were produced at lower costs for labor, materials and overhead charges than now have to be borne. Wages and materials are higher, and if automobile production is reduced as much as now seems likely each car produced will have to carry substantially more overhead than during the past twelve months. Manufacturers cannot base their prices on past costs, but must consider the prospect for the future if they are to keep on producing.

This is illustrative of some of the complexities of price fixing, and there are others. Every price is related to and affected by other prices, and one adjustment makes others necessary. The relations are so involved that it is difficult to determine not only what prices are fair to producers and consumers, but what prices will serve the public interest. There is some evidence that prices of scrap metals have been fixed too low to encourage collection of the necessary supplies, now that costs of collection have risen and there is attractive alternative work for collectors.

Economic science has always taught that a fair price is one which will bring forth the necessary production, or conversely effect the necessary discouragement of consumption. In a war or armament economy other influences of course are operating to stimulate production and restrain consumption, and many of the normal objections against superseding the law of supply and demand are overcome. There is need to co-ordinate the effort and to curb abnormal tendencies that are harmful. Moreover, as an abstract proposition the defense program should not be made the occasion for abnormal profits, and the public interest is paramount to individual rights. The co-operation of the industries is evidence that this is the general view. However, abstractions will not solve the problem, and it will become more difficult as one control leads to another. The danger is that the incentive to production may be weakened, and both the defense program and civilian welfare are dependent upon production.

The country as a whole is concerned about the recent acceleration of price advances. People dread inflation and are sympathetic with anti-inflationary efforts. The lesson of the last war and all other experience, however, is to the effect that price-fixing can be but one element in restraining inflationary trends. It is not likely to be permanently effective unless the causes of cost and price advances are also dealt with.

Money and Banking

Banking statistics give weekly evidence of the growing influence of the defense program upon the credit situation. Bank loans and investments are mounting steadily, and already the combined total for the weekly reporting banks in 101 leading cities stands more than $2¾ billions, or approximately 10 per cent, higher than at the beginning of the year. Moreover, the rate of expansion is increasing, the rise for the first six months being greater than took place in all of last year.

There is no longer any doubt but that an important expansion of bank loans is under way. Since the beginning of the year loans of the reporting banks have increased by nearly a billion dollars, and over the past twelve months by more than $1.8 billions, carrying the total above $10 billions for the first time since 1937. Of these increases, all but a small portion has been in the "commercial, industrial and agricultural" classification, brokers' loans continuing to reflect the low speculative activity in the security markets.

The rise in the business loan group has been truly impressive, going forward week after week with hardly a break. Compared with the first of the year, these loans of reporting banks have expanded by approximately $800,000,000, making the aggregate gain $1.4 billions for the twelve months since last June. At the present level of around $5.8 billions, the total exceeds the previous peak reached in 1937 by more than a billion dollars.

While borrowing to refinance capital structures at lower rates continues to figure in bank loan totals, the main influence is clearly the defense program, with its enlarged needs for credit on the part of defense contractors and sub-contractors and others affected indirectly by the huge sums being poured out by the Government. According to preliminary results of a survey by the Federal Reserve Board, defense loans outstanding by member banks in leading cities totaled $460,000,000 at the end of April, with commitments for future loans an additional $630,000,000; and the totals are constantly increasing. With the huge volume of defense spending still to come, prices rising

and business activity mounting — and taxes all the time increasing — indications are that the rise in commercial bank borrowing may go considerably further.

Rapid as has been the expansion of loans, the expansion of bank holdings of securities has been even greater, owing mainly of course to growth in holdings of U. S. Government obligations. For the reporting banks alone, these rose by $1.8 billions in the first half of the year, to a new high record of $14,304,000,000, more than $2½ billions above June a year ago. It may be assumed that here too the totals are due to go a great deal higher as the Government's borrowing program advances, although all recognize the desirability of keeping defense securities out of the banks as much as possible in order to avoid inflation.

Deposits likewise are expanding, and are certain to go much higher along with increasing loans and investments. However, the interesting thing is that whereas in the past few years deposits were increasing faster than loans and investments, the reverse has been true in 1941. The reason for this shift is mainly the falling off in gold imports, heretofore the principal source of deposit increase and offset to currency expansion. With the diminution of gold imports this year, the deposit-increasing role has been taken over by bank loans and investments, with the resultant deposit gain modified, however, by the continued expansion of currency.

Declining Excess Reserves

The tapering off in the gold movement has had another important money market effect — that of checking and finally reversing the long uptrend of bank excess reserves. So long as gold was sweeping into the country and being sold to the Treasury in the unprecedented volume of recent years, it was the overshadowing money market influence, constantly swelling the total of money market funds and depressing interest rates, notwithstanding a continuing growth in currency demand and bank deposit liabilities.

Now, however, the picture as to excess reserves has changed. With the depletion of British gold reserves, passage of the lend-lease act, and blocking of other foreign funds, gold imports have fallen off as indicated in the following table:

Net Gold Imports of the United States

(In Millions of Dollars)

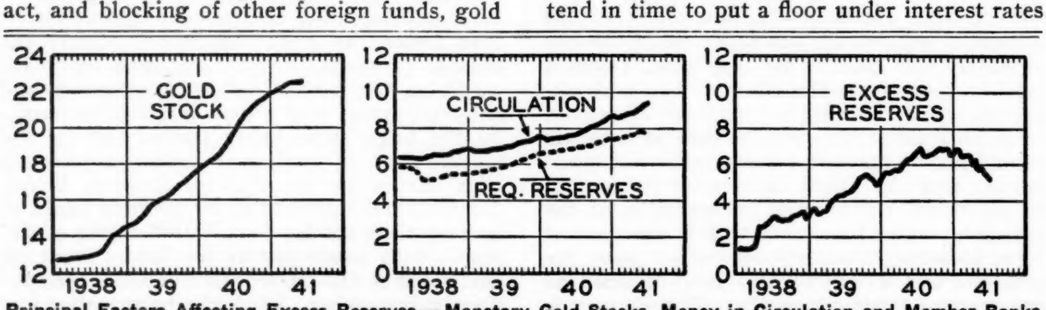
1934*	$1,133.9
1935	1,739.0
1936	1,116.6
1937	1,585.5
1938	1,973.6
1939	3,574.2
1940	4,744.5
1941, Jan.	234.2
" Feb.	108.6
" Mar.	118.6
" Apr.	172.0
" May	34.1
" Jan.-May	668.2

*Figures based on rate of $20.67 a fine ounce in January, 1934 and $35 a fine ounce thereafter.

While total gold imports of $668,000,000 for the five months January through May is still a very substantial sum, it is no longer sufficient to offset the growth of currency and bank deposit liabilities now going forward. Thus currency alone has been expanding at the rate of $1.7 billions a year, while the growth of bank deposits has called for an additional $912,000,000 of required reserves over the past twelve months. In other words, currency and deposit growth have superseded gold as the leading money market influence; and excess reserves, in consequence, are now declining, as shown by the diagram below. On June 25 the total "excess" for all member banks stood at $5,150,000,000, against $6,940,000,000 at the peak last Fall.

More significant, perhaps, than the decline in the total "excess" is the fact that the decline has been concentrated very largely in the leading money market, the excess reserves of New York City banks alone dropping to $2.2 billions, from a peak of $3.7 billions last June.

How far the current decline in excess reserves may go and what its effect upon interest rates may be are, of course, interesting subjects for speculation. It is well known that the monetary authorities have broad powers over the market, and presumably would not hesitate to use them should support action be considered warranted. At the same time the current trend of excess reserves, if continued, would tend in time to put a floor under interest rates



Principal Factors Affecting Excess Reserves — Monetary Gold Stocks, Money in Circulation and Member Banks Required Reserves Against Deposits. (In Billions of Dollars)

and a ceiling over bond prices which would be desirable for many reasons.

As the Federal Reserve Board pointed out in its memorandum on excess reserves, submitted to Congress last December, it is not in the interest of the national economy for money rates to go too low. Already the existing level of interest rates is (to quote the Board) "raising serious long-term problems for the future well-being of our charitable and educational institutions, for the holders of insurance policies and savings bank accounts." Such conditions are discouraging to savings, and render more difficult the sale of defense securities to investors. Moreover, the higher bond prices go the more unstable they become, and the greater the ultimate loss to investors when interest rates return to more normal levels, as they are almost certain to do in time.

Bonds Continue Strong

Notwithstanding the declining trend of excess reserves, expanding commercial demand for money and the prospect of heavy Treasury borrowing to come, the bond market has continued to manifest confidence in the investment outlook, prices in many groups reaching new high levels in the past month. In the case of Treasury issues the demand has been particularly strong for the new taxable issues, all three of which went into new high ground during June, with the recently issued 2½s of 1958-56 selling as high as 104. At the same time, exempt Treasury issues have not been neglected, several likewise establishing new tops.

The same strong demand was manifested for the Treasury's offering of $500,000,000 of new R.F.C. notes to refinance $211,000,000 of maturing ⅞ per cent notes and raise additional new money. The new notes, which carried a one per cent coupon and will mature in April 1944, were so heavily oversubscribed as to necessitate scaling allotments to 7 per cent while the price rose to 100¾. Apart from the continuing influence of very large supplies of idle funds (despite the decline in excess reserves from peak) bullish sentiment in "Governments" was encouraged last month by the agency financing which was interpreted as postponing further direct Treasury financing; also by reports of forthcoming issues of Treasury tax anticipation certificates which it was thought might have the same effect.

High grade corporate and municipal bonds were generally strong along with "Governments". Municipals were especially strong, but toward the close of the month gave evidence of advances having been overdone. While strength in municipal prices and active bidding at competitive sales continued throughout the month, there was a substantial rise in dealer inventories, indicating investor resistance to the record price level. The principal exception to the general firmness of high grade bonds was in the railroad equipment market, where the influence of the increased volume of offerings, together with the expectation of further large offerings to come as a result of the expanding equipment needs of the railroads, brought about somewhat more attractive yields to investors. This development was not illogical inasmuch as equipment issues in the last year have been selling at extremely high prices, closely comparable with "Governments".

Among the lower grade bonds, the activity and strength in second grade rails was notable, reflecting the greatly improved earnings now being reported by the roads and responding to other favorable news such as the approaching consummation of the Erie reorganization.

Expansion of Steel Capacity

The action of the Office of Production Management last month, requesting the steel industry to make plans for expanding its annual producing capacity by 10,000,000 tons as quickly as possible, presents a question of fundamental importance in the planning of the defense program, and one which is likely to arise in other industries as well as steel. Briefly, the issue is whether, in cases where non-defense demands for industrial products cannot be fully supplied after defense needs are met, the industries should be induced to increase their capacity at this time, or civilians should be required to get along with the supplies available, even though some wants go temporarily unsatisfied. In other words, since it is impracticable to have both guns and butter with present plant capacities, should capacity be increased, or will an effort to produce more butter in that way end up in producing fewer guns, or in undesirable effects of other kinds?

It should be emphasized that the question is debatable only with respect to providing for non-defense needs. Where the requirements are for defense there is no controversy, but general co-operation in providing whatever productive capacity will be needed. Furthermore, civilian requirements also should be supplied as fully as the resources and energies of the country will permit, for the standard of living depends upon production. Proposals for large increases in plant construction, however, may involve other considerations.

This question comes into focus more sharply in the steel industry than any other, for several reasons. First, the pertinent facts are available for public examination, in the form of authoritative estimates of production and requirements for steel compiled in reports by Gano Dunn, until recently special consultant to the O.P.M. Second, there is no possible overall shortage of steel for defense needs, for

the second Dunn report points out that "the grand total of all the Army, Navy, maritime and other military requirements, plus all-out aid of every kind for Britain, is less than 25 per cent of the industry's capacity." Third, it seems plain, however, that there will be a deficit in supplies for civilian requirements, and Mr. Dunn estimates that steel requirements in 1941 will exceed the reliable capacity of the industry by 1,400,000 tons and in 1942 by 6,400,000 tons.

Another consideration is that the steel industry is carrying out on its own initiative an expansion which is adding 3,700,000 tons (the Dunn estimate) to ingot-producing capacity during 1941, and will bring further substantial increases in 1942. Where more facilities are required for providing the special kinds of steel needed for defense, such as armor plate, alloy steels and ship plates, the industry recognizes with everyone else that they must be pushed ahead irrespective of other considerations. It is co-operating with the Government in finding the earliest practicable solutions to these special problems, both through new plants and through changes in operations such as putting rolling mills to producing plates instead of sheets. Thus, where dissenting opinions are offered to the O.P.M.'s new proposal, they are not due to recalcitrance or lack of patriotism, but to differing views upon matters of business judgment and public policy. The situation may well be examined upon that basis.

Requirements for Steel

Not many people can have had opportunity to read the Dunn reports. The second report dated May 22nd covers 82 typewritten pages, and some misunderstanding of its conclusions as presented in abbreviated form by the press was doubtless inevitable.

The purpose of the report was to compile reliable estimates of steel capacity and needs. Starting with estimates of Army and Navy requirements for direct defense, the figures given in Mr. Dunn's first report were 2,800,000 tons for the fiscal year 1941 and 4,100,000 for the fiscal year 1942. The figures now included, reflecting the expansion of the program, are 4,300,000 tons for the calendar year 1941 and 6,300,000 tons for the calendar year 1942. They allow for augmentation of the Army to 2,800,000 men, and they include British finished product requirements under the initial lend-lease program.

The Bureau of Research and Statistics of the O.P.M. supplied Mr. Dunn with estimates of civilian requirements for steel totaling 72,500,000 tons in 1941 and 88,600,000 tons in 1942. Adding the above Army and Navy demands, military construction, maritime needs and export requirements, also as submitted by the Bureau, this would represent a total demand of 101,900,000 tons in 1941 and 120,400,000 in 1942. These figures are striking. They are well above any possible production, and they have captured the imagination of commentators. Mr. Dunn, however, considers them over-estimates. He points out that the Bureau itself says that "in these figures no allowance is made for restriction of consumer demand in any of the industries although such restriction is contemplated." In other words, the effect of the forthcoming reduction of output in automobiles and similar durable goods is not allowed for. Even a 20 per cent curtailment of automobile production will make available for other purposes 1,100,000 tons of steel in 1941 and 4,800,000 in 1942.

Mr. Dunn then goes on to give estimates of the labor that would be needed — counting the steel industry, the industries consuming steel, and those indirectly affected, — to produce and consume 101,900,000 or 120,400,000 tons of steel. In the first instance, he says, there would be required 11,862,700 employes, in the second 13,638,700 employes. The former figure is an increase of 4,271,200 and the latter an increase of 6,047,200 over the number of employes for the same purposes in 1940. Mr. Dunn comments, "So great would be the difficulty of adequate labor supply involved in the production and consumption of 120,400,000 tons of steel that I believe it is beyond the realm of practicability."

To allow for curtailment in consuming industries, and for certain duplications he believes to exist, Mr. Dunn reduces the Bureau's estimates of civilian requirements by 5,800,000 tons in 1941, and 10,300,000 in 1942. He also reduces the Bureau's estimate of British requirements, because it considerably exceeds the amount of shipping space likely to be available; he has used a lower figure estimated in consultation with the British Iron and Steel Corporation. His "adjusted Bureau estimates" of total requirements are 87,600,000 tons for 1941, and 102,400,000 for 1942.

Conclusions of the Dunn Report

After dealing with the Bureau's estimates in this way, Mr. Dunn proceeds to consider other information and estimates, including those made by the American Iron and Steel Institute for civilian consumption, which total 69,400,000 tons for 1941 and 68,500,000 for 1942. These are 3,100,000 and 10,100,000 smaller, respectively, than the Bureau's figure. They would indicate a total consumption of 90,300,000 and 92,600,000 tons in the respective years.

For his own estimates Mr. Dunn compromises the differences, and arrives at a figure for total requirements of 89,000,000 tons for 1941 and 97,500,000 tons for 1942. These compare with a reliable capacity on December 31, 1940 of 87,600,000 tons and on December 31, 1941 of 91,100,000 tons. It may be pointed out

that the average capacity during 1941 and 1942 will be greater than the capacity at the beginning of the year; on the other hand, the industry thus far has not operated up to its reliable capacity due to uneven distribution of orders, the coal strike, and other minor factors. This loss of production cannot be made up.

Mr. Dunn refers to his estimates of potential civilian consumption as "very large." They are nearly 50 per cent greater than the consumption in 1939. If none of the other requirements is overestimated, and all the burden of shortage in 1942 falls upon civilian consumption, and the industry operates at reliable capacity, civilians will still have 67,000,000 tons of steel available. This compares with a total supply of 52,798,000 in 1939, and with 61,736,000 in 1929.

Any brief of the Dunn report is necessarily inadequate. It remains to say that its study of steel requirements is exhaustive and careful. While the term "civilian requirements" includes steel for industrial plants, railway cars and other uses which have preference rating, it will probably be agreed that the deficit predicted does not portend any excessive hardship upon the ultimate consumers of steel products.

Mr. Dunn's Views on Plant Expansion

Mr. Dunn makes no definite recommendation on the proposal for 10,000,000 ton expansion. He does, however, emphasize certain of its implications. He points out, first, that if the expansion were horizontal, running from ore mine to finished product, it would cost an estimated $125 a ton, or $1,250,000,000. If part of the ore, coal, transportation and similar requirements could be met out of existing facilities, the cost would be reduced to that extent. He then estimates that construction of such new capacity would require 4,160,000 tons of steel, in terms of ingots, and that even with priorities for equipment the expansion could not be effective in less than two years. Finally, he says:

> It is during the next two years that we shall be passing through the period of our most critical demand for steel. The decision that must be made is whether or not, during that critical period, we shall abstract from the supply of steel 4,160,000 tons to give us an industry capacity 10 million tons greater two or more years hence. It should be borne in mind that in abstracting such steel from other purposes to which it might be applied, we abstract not only the steel but the labor and raw materials that would then go into the production of all the other facilities that make up a horizontal expansion of the steel industry.

In another place, Mr. Dunn says:

> Before we move to make a major expansion of the industry or to divert a part of civilian consumption into other channels, we should take steps to make full use of the capacity which we already have, which has not yet been done.

According to the Dunn report, curtailment of civilian use through 1942 is inevitable. The question is as to shortage in 1943 and beyond. No one knows what the demand for steel at that time may be. It is safe to say that there will still be no shortage for defense needs, however they may expand. Otherwise the outlook is uncertain. If defense requirements are contracting, the capacity now in sight will doubtless be all that can be employed. If defense requirements are still growing there will almost surely be a limiting factor on civilian consumption, namely, bottlenecks in labor, fuel, power or other materials, all of which are necessary to consume steel and to convert it into civilian goods.

Considerations of National Policy

Even if genuine consumer sacrifices will be required unless the 10,000,000 ton expansion is carried out, consideration should be given to reasons why sacrifices may be preferable to forced expansion. Mr. Dunn has pointed to one of these reasons, namely, that construction of new steel plants would compete against other demands for labor and materials at a time when many scarcities are developing. It would divert productive energies, which might serve the defense effort more directly, to the purpose of supplying abnormal and extraordinary civilian demands. It would accentuate the boom, and the existence of the over-capacity, which in all probability could not pay its way after the abnormal and extraordinary demands subsided, would make the readjustment more severe.

On the other hand, deferment of demand for durable goods would do much to minimize the difficulties of adjustment not only to the defense program, but back again to peacetime business. Mr. Marriner S. Eccles, Chairman of the Board of Governors of the Federal Reserve System, made the point clearly in his address before the Chamber of Commerce of the United States on May 1st, when he said:

> This is the time for the public to build up a backlog of future requirements, especially of consumers' durable goods, such as automobiles, housing, etc., that now are using some of the materials needed in defense. Instead of spending existing funds and mortgaging future income for these goods, it would be far better to defer these expenditures until the time when the Government's defense outlays can be reduced. At such a time the backlog of buying power coming into the market will be an offset to the reduced Government expenditures and help to sustain employment and national income.

There is no disagreement that war and preparations for war require saving, and saving is but another word for abstaining from consumption. The current Monthly Survey of the American Federation of Labor says, "Income saved now will be ready when defense production stops, to tide over shifts from defense to civilian work, to create buying power for civilian goods when plants are released for civilian consumption." This is a sound statement for individuals to follow. It is equally sound when applied to industrial planning for civilian requirements, and to national policy.

The "Over-savings" Controversy

A valued reader of the National City Letter has expressed regret that so little comment has appeared in these columns upon the protracted "hearings" of the late Temporary National Economic Committee. He was especially concerned that the "over-saving" theory presented on February 24, 1941, by Dr. Mordecai Ezekiel, should have comment.

While any talk of over-saving may seem highly academic, to say the least, at this time of soaring defense expenditures, the subject is nevertheless of current practical importance for many reasons. Involving as it does the thesis that our economy, as now organized, is no longer normally capable of utilizing the savings it creates, this doctrine is part of the background of proposals for re-distributing wealth, and for greater government control of industry. Its influence has been discernible in the tax and budget policies of the government; and many of the proposals for dealing with post-war problems appear to reflect this philosophy which, if widely accepted, would profoundly affect the future of the private enterprise system.

Announcement last month that the Federal Works Agency is projecting a $5 to $6 billion program of annual public works expenditures, for the six years following curtailment of defense activities, emphasizes the need for thinking now about post-war problems. Are we going to approach these problems on the theory that the private enterprise system has the vitality and recuperative power to go forward as in the past under its own power; or are we going to lay plans on the theory that government must provide stimulus and guidance through permanent pump-priming and regulation and control of our economic life?

Dr. Ezekiel, whose TNEC testimony is taken here as a text — though he is by no means the only proponent of the over-savings idea — has held the position of Economic Adviser to the Secretary of Agriculture under Secretaries Wallace and Wickard, in recent years an important post. Also, he is the author of a book, "$2,500 A Year," (1935) which is devoted to the idea that every family should have an income of not less than the sum named. Much that the book says is very good, as the following quotations show, and the quotations are an appropriate prelude to a discussion of the author's TNEC statement.

The leading thought of the book is that we are not producing enough, and never have produced enough, to provide a decent living for all; but that —

> **we are quite capable of producing enough to establish $2,500, or even more, as the minimum income of every family, without taking away from those who have more.**
>
> **We live in a strange contradiction of richness of opportunity and meagerness of achievement. Our economic system has been incapable of fully utilizing these resources. Instead it has left one-quarter of our labor power idle, to waste away unused, like water over the dam, never to be regained.**
>
> **. . . Divided equally, our entire national production in 1934 was only enough to have given each worker, employed or unemployed, $85 a month. At the record of production in 1929, all that we produced would have provided each worker only $136 a month.**

Writing in 1935, after two years of "recovery," the author refers to the continuance of widespread economic distress, dependence upon federal subsidies, and the general failure of the economic system to regain pre-depression levels. This was six years ago, and yet the same might have been said in 1938, or in 1939 up to the outbreak of the new European war. Nevertheless, despite these deplorable conditions, the author warns that merely raising wages and prices would be no remedy. He says:

> **Of course, we could seem to be better off by marking up prices still higher, but people cannot eat or wear money. If there are not enough houses to go around, doubling wages and doubling rents would not let the people live any better. Incomes must rise faster than living costs, if the workers are to be better off.**

How can these real gains be accomplished. On this point the author is clear and unequivocal — only by increasing production. Continuing, he says:

> **We've been so busy squabbling over how the pie is to be divided that we've failed to see that the pie is too small to begin with. Before we can each have a bigger slice, we must make the whole pie bigger. We must produce more — more goods, more services, more housing, more transportation — before we can expect to live better.**

This is all so true that we are glad to repeat it; and this statement, along with others, evidently establishes Dr. Ezekiel as a non-adherent of the "mature economy" doctrine—that is, that the growth of the country is naturally slowing down and that there is a diminishing amount of work to be done beyond the mere maintenance of our existing plant and equipment.

The Over-Saving Theory

In Dr. Ezekiel's TNEC testimony, a central theme—if not the central theme—was the over-saving thesis.

What is meant by the term "over-saving," and how can we have too much of saving, as implied? Always we have been taught the virtues of thrift, not only for the individual but for the community at large. Most of us have had the idea of saving for the proverbial "rainy day" dinned into us from childhood, while economists have taught us of the need for savings to finance the growth of industry which makes possible the rising standard of living. How, then, can we have too much saving?

The answer of the "over-saving" economist to this question is epitomized in the following excerpts from Dr. Ezekiel's testimony:

> **Other testimony before you has shown that the weak link in the purchasing power chain lies in the use made of savings.**
>
> **At each individual transaction, the amount paid by the purchaser for goods exactly equals the amount**

received by the seller. For all transactions added together, the sums spent must equal the sums received. But as our economy is now organized, a considerable proportion of the funds received by sellers are not respent, but are set aside as savings. Our distribution of income and savings habits are such that as the national income rises, the amount set aside as savings increases much faster than the national income itself increases.

Savings make markets for goods only when somebody actually takes the savings and invests them, by spending them for machinery or plant or other new capital goods.

In other words, over-saving, as here defined, is simply a condition where saving exceeds investment; and money, instead of being put to work in ways that keep it circulating in the community, remains locked up in banks and other lending institutions to the detriment of general purchasing power and business activity. Since it is contended that our present system tends inevitably to develop this disequilibrium, the argument follows that the government ought to take corrective measures.

"Over-saving" or "Under-investment?"

Now, of course, no one denies that *idle* savings are a drag upon the community. But this in itself explains nothing as to basic causes. The question is, what is the real reason why savings remain unemployed?

The fact that money may be lying idle instead of being turned back into active use through loans and investments does not constitute proof that the community is saving too much. It is quite as likely to mean that the community is investing too little; in other words, that something — fear, unwise governmental policies, maladjustments of one kind or another — is impeding the natural instinct of entrepreneurs to employ these savings in expanding their operations in hopes of greater profits. Business men know of periods like this in the past, when money has been a drug on the market; but always they have been followed by renewed upswing in which money was again wanted for new development.

While it may seem like hair-splitting to try to distinguish between "over-saving" and "under-investment," the distinction nevertheless is important because of the great difference that it makes in seeking solutions. Those who believe that the difficulty is due to over-saving will be found supporting efforts to cut down and distribute savings. Hence such measures as the undistributed profits tax to cut down corporate savings, high taxation of the upper income brackets where most individual saving occurs, and government spending to offset or force a dispersion of savings.

On the other hand, those who believe the difficulty to be due to under-investment are more likely to ask why investors are hesitant and to endeavor to remove the obstacles.

To choose the wrong remedy would be serious, especially if it has the effect of mistakenly checking the growth of savings, upon which all progress depends.

Only one premise would warrant the conclusion that the country, up to the war boom, was saving too much. This is the extraordinary "mature economy" theory mentioned earlier, which holds that due to certain long-term changes in the economy — slowing down of population growth, for example — opportunities to employ capital in private investment are no longer sufficient to absorb the available savings. Economists of this school are consistent in urging that the government must step in with special measures, including public works expenditures, to correct this disequilibrium.

We regret that space limitations will not permit here a discussion of this theory. The subject was discussed at considerable length in our Letter of April, 1940. Moreover, Dr. Ezekiel's testimony, with which we are primarily concerned, does not suggest that he is a subscriber to the "mature economy" theory. Neither in "$2,500 A Year" nor in his TNEC testimony does he attempt to make a case for this idea. On the contrary, he has urged the need for more and more production.

What, then, is the basis of his argument? Speaking before the TNEC, he said:

The testimony already placed before you has shown conclusively that the chronic low industrial production in our economy has not been due to any lack of ability to make goods. Every time that demand has increased, industrial production has increased promptly and swiftly. Thus, from the time the Munich crisis first put the world on notice of the coming war, to the present time, our industrial production has increased from 92 to 139. This is an increase of 51 per cent in 2½ years.

We know all about how to make goods, and how to organize production. But we don't yet know how, in times of peace, to keep the buyers supplied with enough purchasing power to provide markets for all the goods and services we can make.

The reason for this unsatisfactory performance, Dr. Ezekiel goes on to say in passages already quoted, lies in the tendency in our economy for savings to run ahead of investments. Later on Dr. Ezekiel elaborates further, as follows:

Industrial monopolies intensify the inequality of income distribution by diverting more income into large salaries, bonuses, and dividends which go mainly to the small proportion of families at the upper end of the income scale, and by reducing the amounts which go into payrolls at the lower end of the income scale. The per cent of income saved is much higher at these high incomes than at the low. When industrial production expands, big corporations usually increase their profits many times faster than production or payrolls rise.

This further increases the inequality of income distribution and leads to even more over-saving in boom times.

Analysis of the Argument

Dr. Ezekiel introduces no evidence to show that over a period of years there has been any increase in the inequality of income distribution. That would be difficult to do because the figures do not support it. In fact, one of the characteristics of the American economy has been the wide distribution of gains in the standard of living resulting from industrial

progress. Because of this, the standard of living of the American working man has been higher than anywhere else in the world, not by a little, but by much, as witness the wide ownership of motor cars, telephones, modern plumbing and heating, labor saving electrical appliances, etc.

Moreover, anybody who has had industrial experience knows that monopoly in this country is much more of a political bugaboo than a reality; for in every industry we see signs of vigorous competition which has steadily reduced prices and raised the quality of the products—and all in the face of the great advance in wages paid to workers and reduction in working hours.

In fact, the hackneyed expression, "the rich are becoming richer and the poor poorer," is quite untrue of the United States. Nowhere in the world has there been so steady and rapid an increase in the welfare of the common people over long periods of years, and the burden of proof is surely upon those who suggest that some new mechanism is needed for the future, differing radically from the method of private enterprise, mechanical ingenuity, invention and hard work, all supported by the rapid accumulation of savings by all classes of the people.

Analyzing his testimony more closely, it will be found, first, that Dr. Ezekiel appears to accept the existence of depression and idle money as prima facie evidence of over-saving. The fact that a depression may be due to other causes, and idle money merely a symptom, seems to be left out of account.

Secondly, Dr. Ezekiel assumes a great deal when he asserts that "we know all about how to make goods and how to organize production," but suffer from a lack of purchasing power.

The question is, what is it that creates purchasing power? Dr. Ezekiel has answered this question in his book when he says in effect that production is the source of purchasing power.

It is the goods and services that we have to sell that give us power to buy from others; the individual who has nothing to sell or exchange is not a factor in the market. The great difficulty is to keep the vast variety of goods and services coming in the market in right relations to one another, both as to quantities and prices, so that they can pay for one another and be cleared. To do this is a problem in organization; and it is at this point that business enterprise and ingenuity enter the picture. A Henry Ford or a Thomas Edison designs a new product, gathers together the capital, builds factories, employs workers; and it is in this way, through the enterprise system, that new purchasing power is created.

Progress in living standards depends on new ideas, new enterprise, and the taking of risks. It is a dynamic and not a static operation. The people constantly want new goods and are dissatisfied with the old. They want better houses, better automobiles, better electrical appliances, and it is the constant effort to anticipate these human requirements that spells economic progress.

The problem is thus different from one of redistributing the country's annual production of goods, or even of simply increasing the production of the kinds of things we already know how to make. Progress is a constant adventure into new areas. This is not work that is adapted to government control, but calls essentially for enterprise, imagination and the taking of risks.

Even if we should accept, for the sake of argument, all that he says as to the effect of corporate policies on income distribution, Dr. Ezekiel still cannot be right in concluding that this is a cause of over-saving and at the same time be right, as we believe he is, in maintaining that our great need is more production.

For more production means a need for more capital equipment, and hence a greater use for savings. Either he is wrong in saying that we need more production or he is wrong in saying that we have too much saving. In his statement to the TNEC, he expressed the view that any permanent solution of the farm problem must await the time "when industrial expansion will provide full employment in non-farm industries both for the present city unemployed and for the surplus farm population." Yet how can we have the expansion he envisions without the steady growth of savings to develop and improve the industries?

Real Causes for Pre-war Business Lag

The truth is that there are ample reasons for the failure of business to go ahead more confidently prior to the outbreak of the war without resorting to the theory that we were saving too much. For one thing, the country had just been through a great depression which sapped financial resources and violently disrupted normal relations within the economic system; as, for example, in the relation between agriculture and industry. Second, some substantial part of the period was one of great world unsettlement, accompanied by threats of war and great changes in such basic factors as the value of money in which business is done. Third, it has been a period of social turmoil and "reform;" and such periods always are accompanied by hesitation and doubt. Because business must constantly plan ahead, it cannot flourish in an atmosphere of fear and uncertainty. Enterprisers who risk their funds in new undertakings are discouraged and hold back. Especially is this true where reforms

come too fast and go too far, and when no one knows what new ones may be proposed.

And finally—in regard to taxes. While the defense program puts the whole question of taxes in a new light, certain facts should nevertheless be recognized in analyzing conditions up to the war. Apart from the discouraging effects of repeated tax increases upon business incentive and hopes of profits, the present tax system, with its rapidly progressive rates in the upper brackets, has materially reduced the savings of the class of investors from which industry has been accustomed to draw most of its enterprise capital. Thus it has been estimated by one careful student* of taxation that in 1940 the incomes of over $100,000 were probably something like 90 per cent less than in 1929 after payment of income tax and surtax; while in the brackets from $5,000 to $100,000 the shrinkage after taxes between the two periods was probably something over 40 per cent. He further concludes that if full weight is given to estate taxation, total savings after the income and estate taxes on all taxable incomes over $100,000 "are almost certainly a minus quantity."

In other words, instead of our troubles having been caused by excess savings, there is much evidence to show that they may have been due in part at least to an actual deficiency of savings, especially of the kind to take new risks and blaze new trails upon which full recovery depends.

The "Planned Economy"

We conclude this discussion with one more quotation from Dr. Ezekiel's "$2,500 A Year" as typical of a rather common tendency to charge the economic system with "failure" to achieve that perfection that is granted to no human institution. He said:

> During three long years from 1929 to 1932, the modern profits system had a chance to show what it could do to create prosperity. During this period none of the New Deal restrictions were present. If unrestricted activity could provide prosperity, why didn't it do so in 1932?
>
> The suffering and hardships of the great depression, and the failure of "automatic" recovery to appear, are ample proofs that the theories of the profit system do not work under the conditions of today. If they did, with our greatly increased productive power, poverty would be a thing of the past. Why does poverty persist in the midst of plenty?

*"Savings, Investment, and Consumption," by Imre de Vegh; American Economic Review Proceedings, Vol. XXX, No. 5 February, 1941.

Letting pass without argument the implication that there were no "restrictions" within the economic system in 1929-32, we wish to emphasize the fact that here is an indictment—based on only three years' performance — three years of world-wide chaos, clearly an aftermath of the great dislocation of the World War —of a system of enterprise which over the past 150 years has wrought a miracle in raising the living standards of mankind.

Because of these three years of "failure," Dr. Ezekiel would scrap the profit system in favor of a vast national planning system, managed of course from Washington—the "planned economy"; and there are others who believe as he does. Always the distant pastures look the greener! We know the shortcoming of what we have and idealize that which we have not.

One of the notable books of the year is "Prepare for Peace," by Dr. Henry M. Wriston, President of Brown University. It is an able review of the war ventures and plans for peace in which the United States has been involved, including the important wars in Europe during our time. The author is a broadly informed man, an economist and student of international relations. Among other topics, he discusses the "planned" or "managed" economy idea, vigorously attacking its vaunted efficiency, and pointing out how inevitably it leads not to abundance but to scarcity, not to freedom but to dictatorship.

In closing, we commend to the reader's consideration Dr. Wriston's observation on a statement by the chairman of the TNEC that "if we are frank with ourselves, we must realize that if the democratic world had succeeded in the past in distributing the products of commerce and industry among the masses, if it had been successful in preventing the growth of the proletariat, there never would have been such a thing as the rise of the totalitarian state."

Dr. Wriston said: "He measured democratic success not against other systems in a real world, but against an utopian absolute. Because our democracy had not yet achieved what has never been done anywhere, he counted it a failure, despite the fact that it came nearer the goal than any other nation, or any other system of economy."

THE NATIONAL CITY BANK OF NEW YORK

The National City Bank of New York

Head Office* · 55 WALL STREET · *New York

Condensed Statement of Condition as of June 30, 1941

INCLUDING DOMESTIC AND FOREIGN BRANCHES

ASSETS

Cash and Due from Banks and Bankers	$1,030,259,007.54
United States Government Obligations (Direct or Fully Guaranteed)	1,148,145,868.66
Obligations of Other Federal Agencies	50,725,632 90
State and Municipal Securities	179,531,021.53
Other Securities	66,033,697.04
Loans, Discounts and Bankers' Acceptances	603,571,042.05
Real Estate Loans and Securities	6,791,688.48
Customers' Liability for Acceptances	8,544,512.68
Stock in Federal Reserve Bank	4,260,000.00
Ownership of International Banking Corporation	7,000,000.00
Bank Premises	40,227,750.63
Other Real Estate	156,622.40
Other Assets	628,999.18
Total	$3,145,875,843.09

LIABILITIES

Deposits		$2,934,824,737.56
Liability on Acceptances and Bills	$18,275,697.01	
Less: Own Acceptances in Portfolio	6,895,402.30	11,380,294.71
Items in Transit with Branches		25,297,158.49
Reserves for:		
Unearned Discount and Other Unearned Income		4,066,655.15
Interest, Taxes, Other Accrued Expenses, etc.		7,606,196.74
Dividend		3,100,000.00
Capital	$77,500,000.00	
Surplus	65,500,000.00	
Undivided Profits	16,600,800.44	159,600,800.44
Total		$3,145,875 843.09

Figures of Foreign Branches are as of June 25, 1941.

$77,135,910.88 of United States Government Obligations and $14,177,264.20 of other assets are deposited to secure $57,963,996.20 of Public and Trust Deposits and for other purposes required or permitted by law.

(Member Federal Deposit Insurance Corporation)

City Bank Farmers Trust Company

Head Office* · 22 WILLIAM STREET · *New York

Condensed Statement of Condition as of June 30, 1941

ASSETS

Cash and Due from Banks	$ 37,232,582.97
United States Government Obligations (Direct or Fully Guaranteed)	44,950,961.32
Obligations of Other Federal Agencies	4,735,797.12
State and Municipal Securities	7,961,557.43
Other Securities	1,857,378.93
Loans and Advances	4,171,428.78
Real Estate Loans and Securities	6,614,445.56
Stock in Federal Reserve Bank	600,000.00
Bank Premises	3,844,136.25
Other Real Estate	398,620 78
Other Assets	1,649,463.34
Total	$114,016,372.48

LIABILITIES

Deposits	$ 86,823,117.50
Reserves	1,910,251.80
Capital	10,000,000.00
Surplus	10,000,000.00
Undivided Profits	5,283,003.18
Total	$114,016,372.48

$1,578,810.00 of United States Government Obligations are deposited with public authorities for purposes required or permitted by law.

(Member Federal Deposit Insurance Corporation)

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